As both the Equal Credit Opportunity Act (ECOA) and the Interagency Fair Lending Examination Procedures remind us, “A creditor shall not discriminate against an applicant regarding any aspect of a credit transaction”; this includes small business and commercial lending. The focus of fair lending regulatory supervision and enforcement has been on mortgage and consumer lending; however, commercial loans are within the sight lines of regulators.

Fair lending review of commercial lending can be challenging because of the lack of demographic information to form the basis of the review, making it difficult to apply prohibited-basis categories. In fact, except for residential mortgage loans, ECOA prohibits collection of government monitoring information to ensure the applicant’s race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to contract), income derived from a public assistance program, or the applicant having exercised any right under the Consumer Credit Protection Act are not considered in credit decisions.

How do you achieve success and mitigate fair lending within commercial products? You take a step-by-step approach and define, identify, control, and manage fair lending risk through the compliance management tools you have in place. First, understand the purpose of fair lending and define it in a way that fits with your commercial products. While the rules governing fair lending may rely on the prohibited categories, the implementation of fair lending in a commercial loan operation is about fairness and equal treatment. So, one way to bridge the gap is to consider the elements of equality and apply them to your commercial processes.

Begin by providing clear definitions and examples of the types of discrimination that may occur and how building consistency in the commercial lending processes can help lower fair lending risk. To discriminate against an applicant means to treat an applicant less favorably than other applicants. Look for overt and comparative activities such as:

- Failing to provide information or services or providing different information or services in any aspect of the lending process, including credit availability, application procedures, or lending standards.
- Discouraging or selectively encouraging applicants with respect to inquiries about or applications for credit
- Using different standards to evaluate collateral, providing unequal access to credit, or unequal terms of credit based on location of the property securing a loan or the business.
- Treating a borrower differently in servicing a loan or in applying default remedies.

The above is not all-inclusive, but it helps to illustrate that, although commercial loans are often based on very specific and unique criteria, by creating consistency in the process, documentation, and methodology within the commercial organization, the bank will begin to mitigate fair lending risk.

Defining the risk is the first step, but, to mitigate risk, you must find it. Commercial lending policies and processes should be evaluated as part of the fair lending risk assessment. It is important to understand what risk factors apply and how to consider those as part of the overall assessment. There are specific risk factors that are associated with commercial lending that align to underwriting, pricing, marketing, and redlining. Be sure to consider the following:

- Vague or subjective underwriting
- Risk-based pricing that is sub-
A bank’s inherent commercial fair lending risk should be considered to help determine the controls and monitoring required for fair lending. Consider inherent risk factors such as the products offered, the types of customers (small businesses or large companies), the size of the portfolio, etc. The following commercial-specific controls should help drive consistency in the process:

- Credit policy
- Written underwriting and pricing standards
- Exception guidelines including exception authority, tolerances, and trending
- Defined and documented lending and pricing authority and discretion
- Marketing policies
- Marketing and processing center staffing resources, including dollar allocation
- Analysis of branch locations and services

Don’t forget, servicing matters. For commercial loans it can be difficult to have structured processes, especially in relation to complex large commercial workouts. When possible, the bank should formalize these processes. Developing and requiring written requests for modifications and extensions and the levels of decision authority can help mitigate the fair lending risk associated with commercial workout plans. Anytime you can document processing times, follow set criteria/requirements for decisions, provide access to other languages for limited English proficiency customers, ensure fair property evaluations in foreclosures, etc., you create consistency in process. When you have consistency in process, it helps to mitigate fair lending risk.

Once you have identified the risks and controls, testing and monitoring are key detective controls. It is within these controls that you will document that your bank’s policies and procedures are not only working, but they aren’t causing fair lending risk. Review outliers, exceptions, and denied transactions, looking for patterns that are outside of policy and procedure. Consider branches or lenders that are outside of tolerance or seem focused on certain areas or clients and review transactions to ensure decisions are clear and within set lending authority.

Concentrate data analysis on:

- Denial rates
  - Based on high minority geographies
  - Application and loan demographics
  - Calculate the percentage of lending in high minority geographies
- Map applications to illustrate lending patterns and market penetration in all census tracts within the CRA assessment or reasonably expected lending areas.
- Exception tolerance, trending, and when warranted review who or who is not receiving exceptions to underwriting or pricing guidelines

Structure a file review to:

- Decision/Pricing of applications, including modifications
  - Try when possible to target applications located in high minority areas or when documentation indicates women or minority ownership
  - Evaluate pricing and denial decisions for consistency with policy
- Select a sample of both denied and approved loans to review for consistency with loan policy
  - When possible, find similarities in business, purpose, loan amount, term and type of collateral for denied loans sampled

In addition, evaluate the data from decisions made for payment plans, including loss mitigation, to ensure adherence to policy and procedure and that there are no fair lending impacts.

Lastly, success comes with including commercial lending in your compliance management program. Be sure to include:

- Understanding of fair lending risk in the commercial product
- Fair lending training
- Documentation of policies and processes including fair lending
- Level of discretion and the exception process including tracking and trending
- Fair lending risk assessment
- Fair lending performance analysis including lending patterns and loan file reviews
- Senior management/Board reporting of commercial fair lending risk
- Compliance management program partnership with commercial division

By ensuring commercial lending is incorporated into your compliance management system, you will be more successful in mitigating commercial fair lending risk and able to show examiners an awareness and understanding of how those risks fit into the bank’s risk profile and the steps the bank has taken to prevent or mitigate any risks.